Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Knight	Analyst:	Angela Raygoza	Bill Number:	AB 340
Related Bills:	See Legislative History	Telephone:	845-7814	Amended Date:	March 24, 2009
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Employee Tax Credit

SUMMARY

This bill would provide a tax credit for each qualified employee employed by a qualified employer, as specified.

SUMMARY OF AMENDMENTS

The March 24, 2009, amendments would do the following:

- Modify the amount of the hiring income tax credit;
- Define “qualified employee,” “headquarters,” “qualified employer,” and “qualified job;”
- Specify the availability of the credit for qualified employers; and
- Provide a carryover period.

Because the March 24, 2009, amendments are substantive, the department’s analysis dated February 18, 2009, has been significantly revised, which includes the “This Bill,” “Implementation Considerations,” “Technical Considerations,” “Economic Impact,” and “Policy Concern” discussions.

PURPOSE OF THE BILL

According to the author’s office, the purpose of this bill is to provide a tax incentive to businesses to stimulate the economy and promote hiring in California.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2009.

POSITION

Pending.

Board Position:			Department Director	Date
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_______ N	_______ OUA	___X___ PENDING		

ANALYSIS

FEDERAL/STATE LAW

Current federal law allows employers who hire employees from a "targeted group," as defined, to elect to claim a work opportunity credit (WOTC).[1] The credit is equal to 40 percent of the qualified first-year wages for that year. The amount of the qualified first-year wages that may be taken into account with respect to any individual is limited to $6,000 per year ($12,000 per year in the case of any individual who is a qualified veteran).

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Under the Government Code, state law provides for several types of geographically targeted economic development areas (G-TEDAs): Enterprise Zones (EZs), Manufacturing Enhancement Areas (MEAs), Targeted Tax Areas (TTAs), and Local Agency Military Base Recovery Areas (LAMBRAs).

Under the Revenue and Taxation Code, existing state law provides special tax incentives for taxpayers conducting business activities within a G-TEDA. These incentives include a hiring credit, sales or use tax credit, business expense deduction, and special net operating loss treatment. Two additional incentives include net interest deduction for businesses that make loans to businesses within G-TEDAs and a credit for employees working in an EZ.

Hiring Credit: A business located in a G-TEDA is eligible for a hiring credit equal to a percentage of wages paid to qualified employees. A qualified employee must be hired after the area is designated as a G-TEDA and meet certain other criteria. At least 90 percent of the qualified employee's work must be directly related to a trade or business located in the G-TEDA and at least 50 percent of the employee's services must be performed inside the G-TEDA.

The credit is based on the lesser of the actual hourly wage paid or 150 percent of the current minimum hourly wage, under special circumstances for the Long Beach EZ, the maximum is 202 percent of the minimum wage. The amount of the credit must be reduced by any other federal or state jobs tax credits, and the taxpayer's deduction for ordinary and necessary trade or business expenses must be reduced by the amount of the hiring credit.

Newly enacted state tax law SBX3 15 (Calderon, Stats. 2009, Third Extraordinary Session, Ch. 17) allows a credit, for taxable years beginning on or after January 1, 2009, to a qualified employer in the amount of $3,000 for each qualified full-time employee hired in the taxable year, determined on an annual full-time equivalent basis. The credit is allocated by the Franchise Tax Board (FTB) and has a maximum cap of $400 million for all taxable years. The credit remains in effect until December 1 of the calendar year after the year in which the cumulative credit limit has been reached and is repealed as of that date. Any credits not used in the taxable year may be carried forward up to eight years.

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[1] Internal Revenue Code (IRC) 51-Work Opportunity Credit

Under current state law, the Corporation Tax Law allows the assignment of certain credits to taxpayers that are members of a combined reporting group and adds the following provisions:

- Provides that an "eligible credit" may be assigned by a taxpayer to an "eligible assignee."
  - "Eligible credit" means any credit earned by a taxpayer in a taxable year beginning on or after July 1, 2008, or any credit earned in any taxable year beginning before July 1, 2008, which is eligible to be carried forward to the taxpayer's first taxable year beginning on or after July 1, 2008.
  - "Eligible assignee" means any "affiliated corporation" that is a member of a combined reporting group at certain specified times.
  - "Affiliated corporation" means a corporation that is a member of a combined reporting group.
- Provides that the election to assign any credit is irrevocable once made and is required to be made on the taxpayer's original return for the taxable year in which the assignment is made.

Current state law limits the amount of allowable tax credits for each taxable year beginning on or after January 1, 2008, and before January 1, 2010, to an "applicable amount." "Applicable amount" is equal to 50 percent of the tax before the application of any credits. Any disallowed credit remains a credit carryover to subsequent years and the credit carryover period is increased by the number of taxable years the credit amount was disallowed. Taxpayers with business income subject to tax of less than $500,000 are excluded from this law.

<u>THIS BILL</u>

For taxable years beginning on or after January 1, 2009, this bill would provide a qualified employer with a tax credit of: (1) $3,000 for each qualified employee, or (2) $5,000 if the wage paid to a qualified employee is 200 percent or more than the average wage in the county in which the qualified employee is located.

This bill would define the following:

- "Headquarters" means the principal central administrative office in California of a qualified employer that employs 30 or more qualified employees at that office.
- "Qualified employee" means an employee who is a resident of California that is employed by the qualified employer on a qualified job.
- "Qualified employer" means a taxpayer that is a person engaged in a trade or business within California that has either established a headquarters within California or relocated a headquarters to California.
- "Qualified job" means employment located at the qualified employer's headquarters that is full-time employment, as defined by law and regulation, and that pays wages that equal or exceed the average wage in the county in which the headquarters are located.

In addition, this bill would provide rules for aggregating affiliated employers for purposes of determining an employee tax credit. FTB would be allowed to prescribe appropriate regulations, including any regulations necessary to avoid the application of this paragraph through split-ups, shell corporations, partnerships, tiered ownership structures, or otherwise.

This bill would require the credit to be available to a qualified employer for the first taxable year and succeeding year where the qualified employer's headquarters are established within, or relocated to, California.

This bill would allow unused credits to be carried over for 11 years or until exhausted.

This bill would specify that any deduction allowed for the same qualified wages would not be reduced by the amount of this credit.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

This bill uses terms that are undefined such as, "qualified wage" and "average wage." The absence of definitions to clarify these terms could lead to disputes with taxpayers and would complicate the administration of this credit.

This bill would allow the qualified employer to receive a $5,000 credit if the wages paid to the qualified employee are 200 percent or more than the average wage in the county in which the qualified employee is located. This bill fails to specify the source for the amount of average county wages. The department lacks the expertise to determine the source for the amount of average wage of each county to the extent there are several different wages published. It is recommended the bill be amended to identify EDD as a source to identify average county wages.

In addition, this bill specifies the 200 percent average wage would be determined by the county in which the qualified employee is located. It is unclear what the author means by "qualified employee is located." This could mean the employee's residence or the location of employment, including if the employee lives in a county with a low average wage but works in a county with a higher average wage. If this is not the author's intent, the author may wish to amend the bill to clarify the term "located" in order to ease the administration of this bill.

This bill would require a qualified employee to be a resident of California. Because residency examinations are evasive and complex, the requirement for an employee to be a resident of California would be a burden to the employer. If the author's intent was to require an employee to live in California, the term "resident" should be replaced with "live in this state."

Because this bill provides for a tax credit for the same period for which credits are limited to 50 percent of tax liability, it would be subject to the 50 percent limitation under current law.[2] If this is not the author's intent, it is recommended the bill be amended to exclude the credit from the
50 percent limitation.

This bill would allow the credit to be available to qualified employers for the first taxable year and succeeding year from the time the qualified employer's headquarters are established within or relocated to California. It is unclear what the author means by "available" for the first taxable year and succeeding taxable year, although it is assumed that the author intends the credit to be allowable for the taxable year of establishment or relocation of the headquarters to California and the subsequent taxable year. If this is not the author's intent, the author may wish to amend the bill to clarify how this provision would operate in order to ease the administration of this bill.

TECHNICAL CONSIDERATIONS

Amendments 1-5 have been provided to correct technical errors.

This bill provides rules for aggregating affiliated corporate employers under the personal income tax (PIT) section. To ease administration of this bill and prevent confusion with taxpayers, it is recommended that the bill be amended to provide PIT rules for affiliating employers in the PIT section.

This bill uses the same Revenue and Taxation Code (R&TC) sections -- 17053.80 and 23623 -- as those used in the recently enacted Jobs Tax Credit. To prevent chaptering issues, it is recommended the author use different sections to identify the bill within the R&TC.

LEGISLATIVE HISTORY

SB 508 (Runner, 2009/2010) would provide a tax credit for a qualified taxpayer on the first $6,000 of wages paid or incurred to a qualified employee and would be subject to the recently enacted 50 percent credit limitation. This bill is currently in the Senate Revenue and Taxation Committee.

SB 612 (Runner, 2009/2010) would provide a tax credit of $500 per month for each qualified employee employed by a taxpayer and would be subject to the recently enacted 50 percent credit limitation. This bill is currently in the Senate Rules Committee.

ABX3 15 (Stats. 2009, Ch. 10) and SBX3 15 (Stats. 2009, Ch. 17) provided a credit of $3,000 for each net job increase and is excluded from the 50 percent credit limitation.

AB 2365 (Correa, 2003/2004) would have allowed a credit for wages paid to a qualified employee who is hired in the taxpayer's manufacturing trade or business. This bill failed passage out of the Assembly Appropriations Committee.

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[2] Revenue and Taxation Code section 17039.2 and 23036.2 require all business credits to be limited to 50%. Any disallowed credit remains a credit carryover to subsequent years and the credit carryover period is increased by the number of taxable years the credit amount was disallowed.

SB 1523 (Ashburn, 2003/2004) would have allowed a hiring credit to employers with fewer than 19 employees. This bill failed passage out of the Senate Appropriations Committee.

SB 1876 (Alpert, 2003/2004) would have, among other things, created a Living Wage Opportunity and Revitalization Credit and repealed the Economically Developed Area hiring credits. SB 1876 was amended on April 29, 2004, to be a California earned income tax credit. This bill failed passage out of the Senate Appropriations Committee.

OTHER STATES' INFORMATION

Florida allows businesses located in an EZ a credit based on wages paid to new employees. Other wage-based credits are offered to businesses that are located in high crime areas or in rural areas.

New York allows a wage credit to a business that hires a full time employee, either one in targeted group or not, for a newly created job in an Empire Zone.

Illinois allows a job tax credit for taxpayers conducting a trade or business in an EZ or a High Impact Business. The credit is $500 for each eligible employee hired to work in the zone during the tax year. It is available for eligible employees hired on or after January 1, 1986.

Massachusetts allows a Full Employment credit to employers who participate in the Full Employment Program and continue to employ a participant for at least one full month. The taxpayer may claim a credit of $100 per month of eligible employment per participant, up to $1,200 per participant.

FISCAL IMPACT

If the implementation and technical considerations addressed in this analysis are resolved, the department's costs are expected to be minor.

ECONOMIC IMPACT

<u>Revenue Estimate</u>

This bill would result in the following revenue losses:

Estimated Revenue Impact of AB 340 As Amended On March 24, 2009 For Taxable Years Beginning On or After January 1, 2009 Enactment Assumed After June 30, 2009 ($ in Millions)			
Fiscal Year	2009-10	2010-11	2011-12
Revenue Loss	-$150	-$230	-$250

This analysis does not consider the possible changes in investment activity, employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The revenue impact of this bill would depend on the amount of qualified employee credits generated by qualified employers with headquarters established or relocated within California during 2008 or later, and the amount of credits applied to reduce tax liabilities each year.

This estimate was developed in the following steps:

- Step 1: Estimated ten firms that would relocate their headquarters to California each year:

  A recent business study published in September, 2008, indicates approximately 20 firms relocate into California each year. This was reduced by 50 percent to reflect current economic conditions.

- Step 2: Estimated 1,900 start-up firms with 30 or more employees during first two years of commencing business in California:

  The Small Business Administration report issued in 2008 indicated that approximately 75,000 start-up firms began conducting business in California. Less than 3 percent of these businesses employ approximately 30 or more employees. It is estimated approximately 1,900 (75,000 firms x <3% firms with 30 or more employees) qualified employers would be established each year.

- Step 3: Estimated 120 qualified employees for firms relocating to California and 30 qualified employees for firms starting-up in California:

  Based on the business study published in September, 2008, it was assumed that 120 qualified employees for each firm relocating to California and a minimum of 30 employees per start-up firm would be needed to qualify for the credit.

- Step 4: Determined approximately 43,500 qualified employees in qualified jobs each year:

  It is estimated that approximately 1,200 employees would be working for qualified employers that would relocate to California (10 firms x 120 employees) and approximately 57,000 employees for qualified employers starting-up (1,900 firms x 30 employees) – a total of 58,200 employees (1,200 relocated employees + 57,000 established employees).

  It is assumed that 75 percent of the 58,200 employees would be in a qualified job. This produces approximately 43,500 qualified employees in qualified jobs (58,200 x 75%).

- Step 5: Assumed 40 percent of qualified employees earn average pay in a county and 60 percent earn double the county average.

  The estimate assumes that an employee that would work at any headquarters and would be determined to have central administrative responsibilities could qualify for the proposed credit. For firms having just one business location that would include central administrative responsibilities, any qualified employee working at that location would generate a credit for the qualified employer whether or not their individual job duties were administrative by nature or a manufacturing job.

- Step 6: Computed total credits generated in 2009: $360 million.

  Given the above assumptions and projections, approximately 17,400 qualified employees (43,500 employees x 40% earning average pay) would generate a $3,000 credit for a total of approximately $52 million (17,400 x $3,000). An additional 26,100 qualified employees (43,500 x 60% earning double the average pay) would generate a $5,000 credit, for a total of approximately $131 million (26,100 x $5,000). The sum of credits generated by each of these two categories of qualified employees is approximately $180 million ($52 million + $131 million).

  This credit would be available in the first taxable year and the succeeding taxable year in which a qualified employer has either established within or relocated to a headquarters in California. In any given year, there would be two groups of qualified employers reporting credits. That is, qualified employers reporting the credit in the first taxable year and those in the succeeding taxable year reporting the credit for the first and second year. The credits generated would be $360 million ($180 million x 2) in a single year to reflect these two groups.

- Step 7: Calculated applied credits in 2009: $100 million.

  In 2009, of the $360 million in credits generated, it is assumed 70 percent would be reported on original returns, or approximately $250 million ($360 million x 70%). The remainder would be reported on amended returns. It is assumed that 40 percent or $100 million ($250 million x 40%) of the credits generated on original returns would be applied to tax liabilities. Carryover credits are assumed applied over the succeeding eight years. Fiscal year 2009-10 estimates include approximately $90 million in reduced 2009 tax liability and $60 million in 2010 estimated tax payments for a total of approximately $150 million in revenue losses. Taxable year estimates are converted into fiscal year cash flow estimates in the above table.

LEGAL IMPACT

This bill contains provisions that would limit the credit to employers that employ residents of California while denying the same incentive if nonresidents are employed. This bill could raise constitutional concerns under the Commerce Clause of the United States Constitution because it could appear to favor employers that hire or have hired California residents as “qualified employees.”

This credit would be limited to an employer whose principal central administrative office would be located in California. Although the principal office could be the location of where the operation is managed, not where the work is performed, restrictions based on the location of a business could be subject to challenge as unconstitutional discrimination in favor of local commerce in violation of the Commerce Clause of the United States Constitution.

POLICY CONCERNS

Because this bill fails to specify otherwise, a taxpayer could potentially claim the credit proposed by this bill, the newly enacted Job Tax Credit (Calderon, Stats. 2009 Third Extraordinary Session, Ch. 17), the Enterprise Zone Hiring Credit, and the Local Agency Military Base Recovery Credit using the same employee wages. Generally, a credit is allowed in lieu of any deduction or credit already allowable for the same item of expense in order to eliminate multiple tax benefits.

This bill lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of the credit by the Legislature.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S PROPOSED AMENDMENTS TO AB 340
As Amended March 24, 2009

AMENDMENT 1

On page 2, line 23, strikeout "central"

AMENDMENT 2

On page, 3, strike out lines line 13-15 and insert:

including any regulations necessary to prevent the avoidance of the purposes of this section through splitups, shell corporations, partnerships, tiered ownership structures, or otherwise.

AMENDMENT 3

On page 3, line 34, after "shall" strikeout "not"

AMENDMENT 4

On page 4, line 15, strikeout "central"

AMENDMENT 5

On page 5, strike out lines 6-9 and insert:

including any regulations necessary to prevent the avoidance of the purposes of this section through splitups, shell corporations, partnerships, tiered ownership structures, or otherwise.